

Keeping Away the Holiday Grinch

Each year, the approaching Holidays spark questions about the federal gift tax and its applicability to year-end gifts. We all quite naturally want to make gifts in this season so that we can watch our loved ones enjoy them. For those who can afford to do so, this also becomes an opportunity to [transfer wealth](#) that may otherwise be taxed in the future for income or estate tax purposes. Typically, a question I often get from clients is “please remind me again how much am I allowed to give...? The simple but unresponsive answer to the question is that a person may give away whatever he or she wants. Aside from proscriptions against defrauding creditors, there is no law restricting how much one may give away. It is the costs of making the gifts that in reality define the situation. Among those costs, as this article will explain, are the potential ramifications of the federal gift tax.

Gift Tax Considerations for Donors

The federal gift tax is a levy that the federal government collects from donors for the privilege of making gifts, i.e., transfers of property and other valuable interests without receiving value (“consideration”) in return. Besides raising revenue, its purposes are to underpin the federal estate tax (i.e., the federal government’s levy on decedents for the privilege of passing wealth after death) and the federal income tax. Because of the federal gift tax, taxpayers may not defeat the estate tax by giving away their assets before they die. At the same time, the gift tax theoretically prevents high bracket income taxpayers from giving away income-producing assets to lower bracket taxpayers to force the income taxation on such income at the recipient’s lower brackets (before the income recipient returns the property and/or its income to the donor). The federal gift tax does not prohibit taxpayers from making gifts of any size. It merely means that if one makes a taxable gift that is not otherwise exempt, as discussed below, the federal government may impose a 40%

excise tax on the value of the gift transferred. If applicable, that tax becomes a cost that the donor needs to consider in making the gift.

Maryland does not have a comparable state gift tax, but transfers of a material part of a decedent's property within two years before death and lifetime transfers by a decedent "in contemplation of death" may be subject to Maryland inheritance tax after the donor's death. Recall however that transfers made to spouses, lineal descendants, parents, grandparents, siblings, and qualified charities are in any case exempt from Maryland inheritance tax.

Lifetime Exemptions from Gift Taxation

Fortunately, Congress has decided that the gift tax should only apply to relatively wealthy people. Like the federal estate tax and until January 1, 2026, federal gift tax is not currently imposed on an individual's first \$11.18 million in otherwise taxable transfers during his or her lifetime. The [Internal Revenue Service](#) has recently announced that, with inflation, this amount will be \$11.4 million starting in 2019. Thus, while lifetime gifts reduce the amount of transfers that can be made estate tax-free after death, married individuals will have a total of some \$22.8 million dollars after the end of 2018 that will be exempt from federal transfer taxes on gifts or post-mortem transfers. And with "Portability", surviving spouses may use whatever exemption goes unused by a first decedent spouse after his or her death if an estate tax return is filed for that spouse.

Unfortunately, current law provides that on January 1, 2026, these exemptions will be decreased by half. For 2026 and beyond, the Internal Revenue Code will limit gift and estate tax-free transfers to a total of \$5.7 million (plus an adjustment for future inflation), or a total of some \$11.4 million for married couples. Even if this reduction stands, the \$5.7 million future exemption amount means that most individuals can make very substantial tax-free gifts if they choose to do so.

Gift Tax Deductions and Annual Exclusions

In addition to the lifetime exemptions from federal gift tax, the Internal Revenue Code also provides for deductions for the value of gifts made to spouses and charities. Because of these deductions, transfers between spouses and contributions to charity do not generally reduce the taxpayers' lifetime exemptions. (For example, if a taxpayer makes a \$20,000 transfer to his spouse, the net value of the gift becomes the \$20,000 transferred minus a \$20,000 marital deduction, or a net taxable gift of \$0.)

Additional annual "exclusions" from gift tax are also available that are designed to allow smaller gifts without reducing the taxpayer's available lifetime exemption. In essence, these are the lifetime gifts (such as Holiday, anniversary and birthday gifts) with which the IRS does not wish to be bothered. The federal government is actually pretty generous with these annual exclusions. Every taxpayer may annually give any number of individuals up to a total of \$15,000 each without such gifts reducing his or her lifetime gift and estate taxation exemption. Moreover, spouses may combine their \$15,000 annual exclusions so that one spouse may use all of this \$30,000 combined exclusion. (Such "split" gifts do, however, require the spouses to file a [federal gift tax return](#) for the year in question to alert the IRS that both are consenting to this combination, and the consent will apply to all gifts made by either during the year.)

The "wrinkle" for annual exclusion gifts is that they are limited to only those gifts the recipient can immediately enjoy. Examples of these are gifts of cash or marketable securities made outright to a gift recipient and most ordinary Holiday, birthday, engagement, and wedding gifts. These eligible annual exclusion gifts are known as "gifts of present value" as opposed to "future value gifts" that cannot be fully enjoyed until some future time. Examples of future value gifts are transfers made to [trusts for beneficiaries](#) and gifts that

don't take effect until a future event. Only gifts of present value are eligible for inclusion in a donor's annual gift tax exclusion. For future value gifts, the donor's lifetime exemption must be applied to prevent gift taxation.

Annual Gift Tax Returns

For most individuals, the real problem with making gifts of future interests or gifts of present value in excess of the annual gift tax exclusions is the requirement that an annual Form 709 United States Gift Tax Return must be filed for years in which such gifts occur. For most, the size of the lifetime exemptions is enough to prevent actual gift taxation, but the return is still required so that the federal government (and the donor) can track where the taxpayer stands with regard to his or her remaining exemption. Like federal income tax returns, these Forms 709 are due by April 15th of the year following the taxable year and are somewhat arcane and difficult to prepare. The cost of worrying about, preparing, and documenting these returns thus becomes the real cost of making gifts that are not covered by available annual exclusions. If all gifts made are present value gifts totaling less than \$15,000 for each recipient, returns are not required.

In this context, what most people mean when they ask how much they are "allowed" to give is "how much may I give to family members and friends without complications like having to file a gift tax return?" From that limited perspective the answer becomes (for 2018) up to \$15,000 per person in total annual gifts (including Holiday and birthday presents) if such gifts may be immediately used and enjoyed by the recipients.

The Internal Revenue Service's End of 2018 Gift to Wealthy Taxpayers

This description of Holiday gift taxation would not be complete without noting the Internal Revenue Service's November 26th "gift" to the wealthy. From the above description, you will

note that a taxpayer may make a total of up to \$11.4 million in lifetime exempt gifts before January 1, 2026, and spouses may make such nontaxable gifts before then totaling some \$22.8 million. What happens if an individual uses all of his \$11.4 million lifetime exemption (or any part in excess of \$5.7 million) before 2026 when the exemption is scheduled to be halved? Prior to the IRS' gift, a very real worry existed that the excess gifts over \$5.7 million would be taxed for estate tax purposes when the donor dies because lifetime taxable gifts are added ("clawed back") into a decedent's taxable estate for estate tax purposes. Worry not! On November 26th, the [Internal Revenue Service](#) announced proposed regulations that will, in essence, increase the lifetime estate and gift tax exemption after 2025 by the value of the gifts given tax-free before 2026 in excess of the post-2025 exemption. As a result, if these proposed regulations are finalized, the added exemption for the pre-2026 tax-free gifts will be locked in forever. And to that, I say Merry Christmas!

On this happy note, we sincerely wish you and your loved ones a Joyful Holiday Season and a safe and healthy New Year.